MEMORANDUM

March 23, 2015

To: Utah Board of Oil, Gas and Mining

From: Steve Alder,
Assistant Attorney General

Re: In the Matter of Crescent Point Energy U.S. Corp. Docket No. 2015-0012, Cause No. 142-13.

I. Introduction

This memorandum is not filed in opposition but as an aid to the Board's consideration of the above matter; it addresses the following questions:

(1) *Does the Board have authority to approve drilling at locations other than the locations permitted by the general well siting rule without establishing drilling units for the lands affected?*
(2) *Can the Board authorize or order sharing of production from such locations in accordance with voluntary agreements assuming not all of the mineral owners have joined in such agreements?*
(3) *Should the Board vacate these and other general well siting rules for these lands as requested, or approve specific well locations?*

II. Background

A. Prior Development.

Petitioners have developed their lands (consisting of two half sections and one quarter section) by drilling one well per 40-acre quarter-quarter section as allowed by the general well siting rule. These general siting rules[1] allow an operator to drill up to one well per each 40-acre quarter-quarter section provided the well is located within a 200 foot by 200 foot window at the center of the 40 acres. This window provides for (and the rules require) a setback of at least 460 feet from the adjacent quarter-quarter section and 920 feet from other wells.

B. Proposed Development Project.

Petitioners now wish to drill new wells at the interior intersections of the 40-acre quarter-quarters so that one well is at the intersection of four quarter-quarter sections. These locations are all interior to the existing wells so that the exterior setbacks for the project area remain 460-feet from the surrounding lands. In this respect, the Request maintains the set back as to the exterior boundaries of the sections as required by the rule, and does not adversely change the risk of drainage for adjacent lands on the exterior of

[1]Utah Admin. Code Rules R649-3-2 and R649-3-3.

the proposed development project. However, the proposed locations are closer to the existing wells than the allowed set-backs and are not at the locations allowed by the general rule.

C. Ownership.

The lands subject to the request consist of the South half of Section 15, the North half of the adjacent Section 16 and they Northwest quarter of Section 16. *See* Exhibit C. The ownership of these lands is a little unclear from the exhibits and RAA. Exhibit A to the Proceeds Allocation Agreements (Exhibits G1and G2 to the RAA) provides details regarding the ownership,

The South half of Section 15 has 69 individual owners each with an equal undivided ownership in the minerals is this half section. All but one have of these owners have leased their interests. With just one exception, the owners have leased to either Ute Energy Upstream Holdings, or Crescent Point Energy U.S. Corp. The exception is a lease to Petroglph Energy. Due to the undivided ownership, all of the 69 owners share equally in production from all wells in the S/2 of this Section 15.

North half of section 16 has 48 undivided owners of the and all but one has leased to either Ute Energy Upstream Holdings, or Crescent Point with the exception having leased to Petroglyph Energy. As a result production for all wells in Section 16 is shared equally among the 48 undivided owners.

The Northwest quarter of Section 16 has just one owner who is the Lamb Trust and the minerals are leased to Ute Energy Upstream Holdings.

III. Analysis.

(1) Does the Board have authority to approve drilling locations that are more dense than the locations permitted by the general well siting rule without establishing drilling units for the lands affected?

The proposed interior wells and lease line well locations do not comply with the provisions of the general well siting rule both because they could be closer to adjoining wells than the 920 feet allowed by the rule and because the rule designates only the center of a 40-acre quarter-quarter as an acceptable locations without obtaining Board approval. However, the general well siting rule does permit a well to be located at a location other than allowed by the rule, R649-3-2.1, if approved by the Board. The language of the rule providing for Board approval of other locations[2] does not limit board approval to specific situations such as a spacing order, but allows for other situations such as increase density or patterns.

[2] R649-3-2-(1) "In the absence of special orders of the board establishing drilling units or authorizing different well density or location patterns for particular pools or parts thereof . . . ."

This provision allowing the Board to authorize wells at other locations does not expressly require consent or notice of adjacent owners or other conditions, however, it is reasonable to assume that when determining if the Board should approve such locations it should look to the overriding principles of the Act. These guiding principles as stated in the Act include protection of correlative rights and prevention of waste. Utah Code §§ 40-6-1 and -3. Correlative rights have been defined by the Act and the rules as the "opportunity to produce his just and equitable share of oil and gas in a pool without waste." Utah Code § 40-6-2;Utah Admin. Code R649-1-1. By filing this Request and seeking Board approval for the requested locations, Petitioners have provided notice to all persons with a right to produce from the lands of the well locations. This notice provides greater protection for correlative rights than the general siting rule does. If the evidence presented at the hearing supports the claim of 20 acre drainage for a well, then permitting these well locations will also reduce waste.

Thus, it appears that the approval of the locations is within the authority of the Board as set out by the rules and consistent with the general principals of protecting correlative rights and preventing waste.

Do other rules or provisions of the Act preclude such an order? Petitioner alleges that the producing formation beneath these lands constitute a common source of supply or pool of oil and gas, and that the area drained by one well is no larger than 20 acres. These allegations in the RAA suggest that the provisions of the Act providing for spacing might be applicable. However, in Utah spacing is not mandatory. Utah Code § 40-6-6(1). The opportunity to produce can be waived by inaction, Adkins v. Board of Oil, Gas & Min., 926 P.2d 880 (1996), and although there *is* an obligation to provide *notice of an opportunity to participate in a well* before force pooling a non-consenting owner and imposing a penalty, Hegarty v. Board of Oil, Gas& Min. , 57 P.3d 1042 (2002), there is no obligation to give such specific notice if there is not to be forced pooling.

In this case, as discussed below, there is a uniformity of ownership within tracts, and production appears to be shared in accordance with lease terms, or by agreement between tracts so there is little possibility that there will ever be a need for forced pooling. However, regardless of ownership and the possibility of future forced pooling, Utah law also does not require force pooling. If the Board approves of the well locations, all of the owners appear to have been given notice of this hearing and the drainage area for the existing wells, thus providing for protection of correlative rights and prevention of waste. There is no statutory reason that would preclude approving the requested locations.

(2) *Can the Board authorize or order sharing of production from such locations in accordance with voluntary agreements?*

The RAA includes the following request: "Proceeds from the production associated with Lease Line Well #1 and Lease Line well #2, have been agreed upon by the mineral owners for those two wells, respectively, as set forth in that certain "Proceeds

Allocation Agreement" included in the Exhibits. "Proceeds from all other interior wells located in the center of the five-spot pattern, on common leasehold ownership, shall be distributed based on the terms of the associated lease ownership to match the existing producing 40 acre spaced wells on the same leasehold respectively." RAA page 5. Thus the RAA asks the Board to approve of the sharing arrangement between the tracts for the lease line wells, and to approve the distribution of proceeds from the interior wells according to the lease terms.

A. Authorization for Board Ordered Distributions of Proceeds.

The difficulty with the foregoing request [for the Board to adopt and order a particular formula for the distribution of proceeds] is that the power of the Board is limited to its statutory powers. If all parties are leased or consent to a method of distribution, then it may be within the Board's powers to order that production be distributed in accordance with the agreement of the owners. This power is inherent in Utah Code § 40-6-9 which assumes existing payment agreements or orders but is not intended as method to make such determinations. Such an order affirming a private agreement may also be within the Board's inherent power to regulate production of oil and gas (40-6-5 (3))(a).

But if all parties are not leased or in agreement, or if there are un-locatable or unknown parties, then the statutory power of the Board to order a distribution requires the Board to first determine the drainage area for the pool from which the well is producing. The Board cannot impose on an unknown or non-consenting owner the agreement of lessees when he is not a party to the lease. The Board must first space the lands and establish that there is an inchoate ownership that then allows for a proceeding to determine the distribution of proceeds. If an operator desires to avail itself of the statutory provisions allowing for forced pooling of a well, the Act requires that prior to or coincident with requesting pooling, the lands must be spaced. Utah Code § 40-6-6.5(1) and (2). The only other authority for the Board to order a particular payment arrangement would be in the case of enhanced recovery project under Utah Code §§ 40-6-7 and 8. There is no other statutory authority for the Board to determine the appropriate distribution of proceeds for a well. This being the case there must either be an agreement as to the method of distribution, or a spacing order.

B. The proposed Lease line wells.

Since the RAA was filed the Petitioner has advised the Division that 100% of the working interest owners affected by the Proceeds Allocation Agreements have all consented. Therefore, the Board need not address the questions that would be associated with issuing an Order for sharing of proceeds that would require the board to both determine a drilling unit size, and determine that notice an opportunity to participate in the wells had properly been provided.

C. Interior Well locations.

With regard to the interior wells, it appears that proceeds have been paid based on undivided ownership of the entire tracts; e.g., the N/2, S/2 or the NW/4. This arrangement should continue for the interior wells since undivided ownership requires

such a distribution. In their Request, Petitioners allege that they are majority mineral owners in all of the lands, but not all. However, since ownership is held in common the degree of ownership held by Crescent Point is immaterial The Board can authorize distribution of the interior wells according to ownership, or not make any order as to distribution because this distribution is mandated to correspond to ownership which is not disputed.

(3) *Should the Board vacate these and other general well siting rules for these lands as requested or approve specific well locations?*

The RAA asks that the Board order that Utah Admin. Code rule R649-3-11(1.1) is inapplicable to any directionally drilled well within the project area so established but then seems to limit this request to the two proposed lease line wells. If the order of inapplicability is limited to these two wells, the Division does not object to the Request. The RAA also asks that the Board not require exception location approval for wells so long as they are within the 460- foot set backs for the project area. No exception locations are identified but just the six interior wells are requested. .

Rather than waive the rules or order that they are in applicable to the project area (a term that is not found in the statutes or rules), the Division believes the RAA should be limited to approving the specific well locations included in the RAA.